No. 12,296

IN THE

United States Court of Appeals

For the Ninth Circuit

E. R. GOOLD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Upon Petition to Review a Decision of the Tax Court of the United States.

OPENING BRIEF OF PETITIONER.

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To the United States Court of Appeals, for the Ninth Circuit:

QUESTION ON APPEAL.

This is a petition to review a decision of the Tax Court of the United States confirming in part a determination by the respondent of deficiencies in income and victory taxes on the petitioner's 1943 income and victory tax return in the amount of $18,632.28, of which determination the Tax Court approved $17,793.84 as valid. (Tr. p. 52.)

JURISDICTION.

Jurisdiction of this Court of Appeals to review the decision is based on Sections 1141, 1142 and 1143 of the Internal Revenue Code (c. 2, 53 U.S. Statutes at L.).

The findings of fact and conclusions of law to which exceptions are taken in this petition are found in the memorandum of findings of fact and opinion of Judge Kern printed at pages 34 to 52 of the transcript of record.

QUESTIONS AT ISSUE.

The petitioner's assignments of error in his petition for review (Tr. p. 64) present two questions for consideration by this Court, namely:

(1) Question of fact.

Did the Tax Court err in its finding of fact from the evidence before it and the presumptions imposed by Section 172 of the Civil Code of the State of California that the petitioner did not acquire his interest in the partnership business of R. Goold & Son by purchase?

(2) Question of law.

Did the Tax Court err in finding that the petitioner's accrued California income tax on his income from the said partnership business was not deductible in computing his income subject to the victory tax in force for the calendar year 1943?

SUMMARY OF ARGUMENT.

(A) There are two questions presented herewith for review: First (one of fact), did Rollin Goold, father of petitioner (hereinafter designated "Father"), give or sell a one-half interest in his business, as of January 1943, to his son E. R. Goold (hereinafter designated "Son")? The Tax Court held that the transaction by which this one-half interest in the business was transferred was one of gift, and thus the earnings of the petitioner thereon are his separate property and taxable as such. Son claims that he purchased the interest from his Father, and thus his earnings are community property and taxable as such.

(B) The second question for review (one of law) is technical and will be discussed in the latter part of this brief.

(C) Tax Involved: The amount of tax in dispute on this appeal is in excess of $17,793.84, the petitioner contending that he is entitled to a refund of approximately $200.00.

(D) Statutes and Regulations: Citations, quotations and applicable statutory provisions and regulations interpretive of them will appear in the argument.

FIRST QUESTION.

Facts.

(A) At all times material to this proceeding, Son was married and living with his wife, Elizabeth—a resident of Stockton, California—and had as depend-

ents during the calendar year three daughters, together with a son born June 29, 1943. (Admission of respondent in his answer—Tr. p. 25.)

(B) Father Goold and Son were equal partners in a general contracting business, conducted under the name of R. Goold & Son. This fact is admitted by respondent. Son acquired his one-half interest therein on January 2, 1943, in consideration for which he gave his promissory note, originally in the principal sum of $100,000.00, bearing no interest, and payable out of 50% of Son's share of future earnings of the partnership. This principal sum of this note was subsequently reduced by endorsements to $70,741.00, in accordance with the agreement under which the partnership interest was acquired by Son. (Admission of respondent in his answer—Tr. p. 25.)

(C) Son and his wife returned their partnership income, fifty-fifty, as community property. Their basis for so doing is found in the California law of community property which holds that property acquired on the credit of community property estate is community property. The pertinent provisions of California law are set forth with citations of California cases in G.C.M. 13620, C.B. XIII-2 (1934), p. 179, over the signature of Hon. Robert H. Jackson, now associate justice of the Supreme Court of the United States. *Cf. opinion in Edwin C. F. Knowles,* 40 B.T.A. 861.

(D) A bill of sale was executed and delivered (Exhibit 1A, Tr. p. 55) which set forth in detail the

business assets which were the subject of the sale. The working papers given to counsel, who prepared the bill of sale for Father, had the word "estimate" set opposite the items designated upon the said paper and said bill of sale as "D", "E" and "F". The value of the other items were taken from the books of the business; these correspond directly with those book values thereof, with the exception of item "C" in which a mistake was made of no particular moment.

ARGUMENT.

(1) It is obvious that this transaction was either gift from Father of the community property of himself and his wife (Son's mother), or it was a sale thereof. In the argument of counsel for respondent, the latter inferentially admitted that the transaction was subject to considerable question as being one of gift, but that this fact could not be used in support of a deduction that the transaction was one of sale. This argument is obviously unsound.

(2) The fact that the parties particularly specified in this bill of sale the value of each item, with the proviso that with respect to those items of which an estimate was made an adjustment in the face amount of the note would be made to correspond with the true value thereof (Son's testimony, Tr. pp. 73 and 121—Father's testimony, Tr. pp. 147, 173 and 180), indicates an intent that this transaction should be one of sale rather than gift. The question before

the Court is the intention of the parties, Father and Son. Each has testified directly in the testimony that it was their intention to make a sale. (Son's testimony, Tr. pp. 71, 81, 117, 120 and 135—Father's testimony, Tr. pp. 139, 149, 150, 169 and 170.) A witness is presumed to tell the truth. However, this intention of mind is best shown by the subsequent acts of the parties. This brings to mind the old proverb, "The acts speak so loudly that one can not hear the spoken word." Counsel for respondent bases his argument upon the fallacious theory that even though all of the forms relating to a sale were complied with and all of the acts of the parties indicated a sale, that is proof positive that the parties had a "gift" transaction in mind—otherwise they would not have been so meticulous. To the mind of the writer of this brief, this is a ridiculous argument. It is conceded that Father wanted Son as a partner, and that the partnership was legally formed, and has been at all times carried on as such. (Respondent's answer, Tr. p. 25, paragraph 5(b).) Now, if Father desired to make a gift of this one-half interest, he could have done so and, simultaneously upon the receipt of that gift, Son could have converted that gift into community property by a simple declaration and transfer to his wife thereof (*O'Done v. Marzocchi,* 34 A.C. 499); thereafter, the tax would have been allocated exactly in the same manner as that for which he now appeals. Likewise, Father could have made a joint gift to Son and the latter's wife, and the same result would have followed. However, Father has testified repeatedly that

he had two children, Son and a daughter; that he did not desire to lessen the value of his estate by the gift of property to one; that it was for this reason he made a sale thereof, to the end that unless Son paid for the partnership interest so transferred, prior to the death of Father, the remaining unpaid portion of the note would constitute a claim in the estate for the benefit of all parties interested therein, including specifically first, his wife, and secondly, his children. (Tr. p. 20.) No gift report was made by Father at the time he made this transaction, which is indicative of the fact that both he, his Son and his counsel (legal and tax) did not have such a type of transaction in mind. The terms of payment which are out of the future profits of the business as earned by himself and Son are not unusual; in fact, it is quite the thing now-a-days to take a young man into business and allow him to purchase his share thereof through profits which are earned by himself and his Father. The Tax Court stated in its opinion that this was an unusual situation, indicating that the parties did not deal at arm's length—thus, it was a reasonable deduction that a gift was intended. The Tax Court is apparently not familiar with the facts of life as they exist at present. Certainly this Father and his only Son did not deal at arm's length. It is the testimony of Father and also that of Son (Son's testimony, Tr. pp. 117 and 118—Father's testimony, Tr. pp. 137 and 138), that as early as 1940, when the Father bought out his partner, Supplick, he requested Son to drop his business and come in and work with him, to the

end that if, in the future, they found themselves compatible that he, Father, would take Son into the business. For three years, Father worked alongside his Son. The latter, according to the testimony, finally became the manager of the business. (Tr. p. 70.) There is considerable evidence in the record concerning the value of Son's services—sufficient that the Tax Court held that as an employee his services were worth a minimum of $10,000.00 a year. (See Tax Court Opinion, Tr. p. 47.) Father was 61 years of age; he suffered from arthritis; he was away from business during the year of 1942 as long as nine weeks at a time. The parties were tremendously busy in carrying out war contracts for the Government. In 1942, Father discussed with mother the advisability of selling Son a one-half interest in this business. At that time, Father had other property, admittedly all community, to the value of some $81,000.00. His interest in the partnership was eventually valued at around $160,000.00. (Father's testimony, Tr. p. 180.) Father discussed the matter with Son. Son was obviously glad to have an opportunity to buy a one-half interest which would give him a security and continuity of financial relationship with his Father. Son was then 32 years of age (Tr. p. 68); he had four children and a wife; he of course had no moneys to pay upon the purchase price—such moneys would have to come from a share of his future earnings.

(3) Counsel for respondent commented in Court upon the fact that since the Son had no money or other financial resources, that this of itself indicated

that the transaction was a gift rather than a sale. We do not follow this argument. Father went to his attorney and to his tax consultant and asked them to prepare the necessary documents and submit a proposition which would not involve him in any tax liability. There is nothing unusual about this. Why should the government participate in any tax in a transaction of this kind which produces no new value? It is no crime for any taxpayer to handle his affairs in such a manner as will lessen his tax burden.

(4) The Tax Court adopted as a fact that the TRUE INTENT of Father was expressed in his testimony that he did not want to discriminate or prefer one child over the other. (Tr. p. 46.) The Court then proceeds upon most erroneous factual deductions. The Court states that if this transaction be deemed a gift, then, upon the death of Father it would be an advance made in contemplation of death and thus the daughter could legally be equalized in the distribution of the estate—a most fallacious reasoning. In the making of a gift prior to death, there must exist a definite intention on the part of the giver and receiver that the property transferred be considered as an advancement in case of death, and that intent must be in the handwriting of either the maker or receiver of the gift. (*Calif. Probate Code* Sec. 1050; *Estate of Rawnsley,* 94 A.C.A. 426, decided November 2, 1949.) There is herein absolutely not one iota of evidence to support such a deduction. If this be a gift, then Son will have received a preference—in the event of his Father's death—over his sister. Father, to avoid

that very situation, had the Son put in his estate a note to the full value of the interest transferred, so that upon his death, Son would owe the estate the value of this interest. Only in this manner could there be an equalization of the interest of daughter and Son upon the death of Father. But we can hear counsel for respondent ask this question: How about the fact that this note is payable out of profits? This Court will bear in mind that the amount of profits that is applicable to the note is one-half of the Son's share—or one-fourth of the total profits. We must assume that Son's services are worth considerable money, and that they materially have and will contribute to the firm's profits—in fact, Son is probably carrying most of the business load. The fact that the Tax Court, under attack from the government, was willing to allow him $10,000.00 yearly salary back in 1943, is proof thereof.

(5) It is presumed that the parties will follow the law. At the time of this transaction, it was, ever since has been and is now the law of California that the husband cannot make a gift of any portion of the community property of the wife and himself without the written consent of the wife.

Civil Code of the State of California, Section 172:

> "*Management of community personal property.* The husband has the management and control of the community personal property, with like absolute power of disposition, other than testamentary, as he has of his separate estate; provided, however, that he cannot make a gift of such com-

munity personal property or dispose of the same without a valuable consideration, or sell, convey or encumber the furniture, furnishings or fittings of the home, or the clothing or wearing apparel of the wife or minor children that is community, without the written consent of the wife."

(See case of *O'Done v. Marzocchi,* 34 A.C. 499, decided November 15, 1949, for California Court's latest interpretation of this section.)

(6) Father testified that at no time did he receive the consent of Mother. None was shown by the Commissioner. (Tr. p. 150.) Mother was in attendance both days of the trial, at the demand of the Commissioner. (Tr. p. 223). There is a well-recognized rule of evidence that testimony in possession of a party and not produced by him at the trial will be deemed to have been unfavorable to his position—thus, the Court should find, as a matter of evidence, that Mother did not consent to any alleged gift of this portion of the community property of herself and her husband—had Father intended to make such a transaction a gift—the same is void under the California rule above set forth.

(7) Elizabeth Goold—wife of Son—was called as a witness for the Government. (Tr. pp. 82 and 83.) On page 83, on cross-examination, Mrs. Goold, in response to the following question by Counsel: "Mrs. Goold, do you recall the time when your husband acquired an interest in your father-in-law's business?", stated: "Well, I heard him—he told me that he had a chance to, but that is about all. He doesn't discuss his business with me. * * * (page 84) * * * Well, he told me

that he would have to sign a note, to get the money to buy into his father's business, to pay for it out of the profits of the business, but other than that, I don't know anything about his business transactions."

(8) Let the Court consider: We have four witnesses testifying positively that it was the intention of the Father to make a sale of the interest to the Son. Two of them, Father and Son, were called on behalf of the Petitioner. One (wife of Petitioner) was called by Respondent, and the other called into attendance (Mother of Petitioner) by Respondent, was never used. We submit that the Government is bound by the testimony—actual and potential—of these two ladies; they were not called as hostile witnesses. Obviously, Elizabeth Goold told the truth in this matter. If Father had intended to make a gift to Son, unquestionably Son would have so told his wife, but repeatedly, in response to a direct examination by Government counsel, she stated no such gift was ever made to her knowledge.

(9) The Tax Court completely disregarded the community property laws of California. Are these Acts nullities in so far as the Federal Government is concerned? Could Son have ever set up against either Father or Mother his contention that this note was fiction—in the face of this positive law of California, that no member of the community can give away the assets thereof? We are positive that any Court and any Jury on this testimony would declare the transaction that of a sale.

(10) Respondent's counsel, as well as the Tax Court, made a point that no interest was chargeable upon this note. Banks at this time were only paying 1% on deposits; we believe that is true likewise up to the beginning of this year 1949. Son left all of his earnings in the business. *We cannot see wherein that is of any particular moment.* The business had use of the one-half of the Son's profits without any interest charge. The amount is so small that it isn't worthy of much comment.

(11) We do, however, come to that upon which counsel for respondent laid great stress and to which the Tax Court gave grave consideration: "Irregular endorsements upon the note". A failure upon the Father to insist that Son pay him upon the note, in accordance with the terms thereof, if not explained, would be evidence of the fact that Father did not intend to enforce payment thereof which, in turn, would be evidence of a gift. We concede that. We state that this is the only *prima facie* weak part of our case. It is, however, clearly explainable. During the years 1944 and 1945, Father did not collect from Son the latter's profit payment for the years 1943 and 1944. The fact that the Father did collect from the Son in cash, which went into his own bank account for the two years of 1945 and 1946 is proof that Father and Son both considered the transaction one of sale. (Tr. p. 81.) Government counsel and the Tax Court have absolutely overlooked and disregarded the collection of payments for these latter years, harping upon the non-payment for the other two

years—the reason for which, in the mind of the writer of this Brief, is clearly apparent.

(12) No moneys were endorsed upon the note nor collected by Father representing Son's share of the profits for the year 1943 operations. Why? The answer given by Father and Son is reasonable. (Son's testimony, Tr. pp. 126 and 127—Father's testimony, Tr. pp. 176 and 177.) In the Fall of 1943, the Government called upon them to renegotiate their war contracts, which constituted practically all of their 1943 business. (Tr. pp. 126, 127 and 188.) This renegotiation was not completed until the Fall of 1944. It is obvious to any practical-minded, impartial-minded person that no determination of profits could be made this year 1943 until after this renegotiation had been completed. Father testified that his attorney, the writer of this brief, advised him not to collect any profits from Son until they could be definitely ascertained—as long as Son left the profits, whatever they were, in the business. Son did this. (Tr. p. 189.) The profits for the year 1944 were ascertained in March, 1945. Why were not the profits of 1944 determined and the one-half of Son's share not paid to the Father? The answer to this is equally conclusive. In the early Spring of 1945 (see McCubbin's Internal Revenue Agent, testimony, Tr. p. 200), the Government sent McCubbin to investigate the validity of the partnership between Father and Son. McCubbin, right from the start, took the position that this partnership was illegal; was void in so far as the Government was concerned; and he reported, as a result of his investiga-

tion, that all of the tax for the preceding years of 1943, 1944, and 1945 should be charged against the Father as an individual; that Son should be allowed a salary during these years of not to exceed $5000.00. The report was made to the respondent Commissioner; hearings were had during the year 1945 and right on up through 1946 and 1947 before him and his staff. As late as August 29, 1946, Miss Wilkinson, Conferee (Exhibit 28, Tr. p. 183) wrote a letter to Son, wherein she stated the Government would recognize the partnership provided that he, Son, would concede that his interest therein was obtained by gift rather than by sale. Father and Son refused to do this. They knew in their own hearts that their partnership was legally formed, in good faith, and this outrageous gestapo maneuver on the part of the Government to force this compromise upon these taxpayers was properly repudiated by them. The writers of this brief desire now to voice an objection not only as counsel for petitioner, but as taxpayers themselves, to this attitude on the part of the Government to concede something which has already been proven, in return for a forced compromise of the taxpayer's rights. The Government, with its unlimited powers and resources, can thus force citizens into unjustifiable positions. It was not until June 5, 1947, that the Commissioner definitely recognized the existence of the partnership. Son's share of the 1945 and 1946 earnings were paid to Father. This procedure was initiated in August, 1947. In other words, the 1945 and 1946 earnings were paid, and we can say to this Court that all other earnings during the

existence of this partnership have been paid to the Father. Cancelled checks were received and entered in evidence. (Exhibits 25 and 27, Tr. p. 81.) It is immaterial whether the payments were endorsed upon the note, as long as they were actually paid. No question was raised concerning the truth of this testimony—in fact, it could not be, because these payments were traced by the Government directly to the bank accounts of Father and then to see whether or not the moneys had been returned to Son. Now, we submit that the reason for the non-payment of the 1943 and 1944 payments of the Son's share of the earnings is reasonably accounted for. In addition thereto, Father testified (Tr. pp. 188 and 189) that the partnership was short of working capital and it was highly advantageous, in view of the large profits made during those two years, that the funds be kept intact in the business as much as possible, and they were so kept.

(13) Respondent's counsel alluded to a "gift" payment which is endorsed upon the note as of December 25, 1943, in the amount of $3000.00. What of it? Father and Mother had a right to make gifts to their children as they saw fit, and if they elected to make them gifts of $3000.00, what better place for the making thereof was there than an endorsement upon this note? If this transfer of interest had been a gift, then we can readily perceive why the $3000.00 should have been given to Son in the form of cash and not as an endorsement upon the note which caused a reduction on the principal amount thereof. This fact, that this reduction was given to the Son to equalize a gift made

to the daughter, is, in our opinion, proof irrefutable that the transaction between Father and Son was one of sale. The same reason applies to the other "gifts" so endorsed upon this note. If this note evidenced a gift, why endorse another gift upon it?

(14) And now we come to that which respondent's counsel, in his brief, viewed with great horror. The endorsement upon the note by counsel for Father and Son of an item of $29,259.00. Counsel for respondent would have it appear that this endorsement had been made by counsel without any authorization from either Father or Son. This is not the truth. Son testified (Tr. pp. 78, 132 and 134) that the endorsement was made by counsel in the presence of himself and his Father and, as he recalled, in their office. Father testified that the endorsement was made with his consent and his authority, but he had forgotten whether the note was in his own or his attorney's possession. (Tr. p. 147.) He did, however, state that this note was continuously in his possession after it was executed and delivered except for the purpose of this endorsement. (Tr. p. 197.) Now, the explanation that counsel for respondent given of how this figure of $29,259.00 was arrived at is correct, but where did he get it? He received it from the parties involved. He received it outside of Court when he asked the writers of this brief to explain the make-up of this item. This was the last case on the calendar—the Court had announced that it wanted to adjourn by three o'clock; we were all rushed—a certain time limit was given to each of us within which to present our case. Regarding matters

which were purely mathematical, we did not deem it necessary to take the time of the Court. It is true that respondent's counsel asked Father many times about an alleged endorsement of $12,000.00. Counsel objected to this question upon the ground that it assumed a fact not in evidence. He was overruled and Father stated he knew nothing whatsoever about an endorsement of this figure. The items figured upon the Bill of Sale amounted to $161,671.96. There was a discrepancy of $20,189.96 because of the corrected figures for items "E" and "F" which had been readjusted in negotiation. This left a total of $141,482.00, one-half of which was $70,741.00, which was the amount that Son should pay for the one-half interest in Father's business. The note was in the sum of $100,000.00. Therefore, the credit which should be placed thereon in order to equalize the same was $29,259.00, which was done, and which facts in explanation thereof, let us again repeat, were given to respondent's counsel outside the Court, at his request. There is no mystery or secret about it.

(15) Respondent's counsel makes much of the fact that Son retained Counsel Smallpage and Scott to represent him in this appearance, thereby eliminating the Government's opportunity to call them as hostile witnesses. In the first place, it is quite natural that Father and Son should retain the counsellor at law who had represented them for years. Second, the argument of respondent's counsel that we could not have been called as witnesses by him is a ridiculous statement of evidentiary law. He could have called

us as witnesses—in so far as Mr. Scott was concerned, there is no law that would make a conversation between him and Father and Son privileged communications; in so far as Smallpage as counsel is concerned, it would have been optional with Son to assert his right of privilege. Mr. Scott, C.P.A. for Son, was present in Court at the request of the respondent, but was not called as a witness. (Tr. p. 223.) It is the old scheme of drawing the red herring across the trail, and in this particular matter it seems to have worked with the Tax Court, because the latter did not pass upon the questions which we respectfully asked this Court to consider. Both counsel at law and in tax have appeared in other matters before Tax Courts, but never, in our experience, have we seen the power of the Government so asserted against clients as was done in this case. The Government demanded some 50 voluminous exhibits of this counsel, who lives 75 miles away from San Francisco, only a very few of which were material. None of these exhibits were incorporated in the transcript in this proceeding. Petitioner has four. These demands for exhibits continued right up to the date of and during the hearing of this matter. We were kept in constant attendance at the Court. This was the last case heard. Father Goold, repeatedly throughout his testimony, stated that he had no idea of making a gift to his Son. Respondent's counsel, in an effort to repudiate him, attempted to lay the ground for the impeachment of his testimony. We quote from the transcript, pages 180, 181 and 182:

Q. And now, at the time that you received this note and had your son sign it, did you ever expect to receive any payments from him on it?

A. I certainly did.

Q. Full payment?

A. Yes, sir.

Q. After adjustments were made for any errors?

A. That is right.

Q. And valuation of certain items included on the Bill of Sale?

A. At the time this note was prepared it was my expectation that he would pay the note in accordance with the terms of the note.

Q. Yet you never insisted that any of the profits be devoted to it, even after the income matter was cleared up?

Mr. Smallpage. Objected to, stating a fact not in evidence. The income tax matter was not straightened up.

The Court. That part of the question will go out. The answer is that he never insisted on his son paying any part of the note.

Q. (by Mr. Marcussen). Now, do you ever recall talking to Mr. McCubbin about this case, who was an Internal Revenue Agent who came out to see you?

A. Some slight conversation. Mr. McCubbin spent considerable time in our office.

Q. Do you ever recall that he questioned you about the amount of the costs of the interest included on the Bill of Sale, and their fair market value, and do you ever recall telling him that you never expected to be paid anything on that note?

Mr. Smallpage. One minute. To which we object on the ground the proper foundation has not been laid, the time, place and people present, and the conversation at least substantially given.

The Court. Objection overruled.

Do you recall that?

Q. (by Mr. Marcussen). On your oath?

The Court. Do you recall saying that?

A. The answer is "no," I don't recall.

The Court. The answer is "no."

Q. (by Mr. Marcussen). Do you recall stating to Mr. McCubbin that this matter had been in the hands of your attorney, and that he had prepared the matter, and that you knew nothing about income taxes, and that, in answer to his questions, you didn't want to fall into any trap?

A. I don't recall any such conversation about falling into any trap, no, sir.

Q. You don't recall?

A. No, sir.

Obviously, the grounds for this alleged impeachment was not laid in accordance with any recognized rules of evidence.

(16) Again, let us look at the answer which the Court put into the mouth of Father Goold. It was "erroneous" to say the least. Even though Father Goold repeatedly stated he had no intention to make a gift, the Court said, referring to Father Goold: "The answer is that he never insisted on his son paying any part of the note." (Tr. p. 181.) Father Goold never made such a statement. It is a positive misstatement of fact. Son did pay to Father in 1947 his

moneys due from 1945 and 1946 operations, and left in the business all of his profits for 1943 and 1944, with the consent of Father.

(17) Again, the respondent, in a desperate effort to impeach Father Goold, called Bruce McCubbin as its witness, the Internal Revenue Agent who, in the early part of 1945, as has been heretofore stated, made an examination of their income tax return for 1943. He was put on the stand, undoubtedly with the expectation that he would testify that Father Goold had told him that he intended to make a gift of this interest in his business, or that he never intended Son to pay upon the note. We quote from the testimony of McCubbin, transcript page 199 to and including page 207:

> BRUCE MCCUBBIN
>
> called as a witness for and on behalf of the respondent, having been first duly sworn, was examined and testified as follows:
>
> Direct Examination
>
> The Clerk. State your name and address.
>
> The Court. Your name is McCubbin, you are an Internal Revenue Agent, is that correct, in the Stockton District?
>
> The Witness. Yes.
>
> The Court. Go ahead.
>
> Q. (By Mr. Marcussen). In the course of the exercise of your duties, did you have occasion to investigate the income tax liability of Mr. Rolly Goold?
>
> A. I did.

Q. And in the course of that investigation, did you have talks with him about his liability from time to time?

A. I did.

Q. And when did you first undertake this investigation?

A. As I remember, the investigation of the various joint ventures in which he was interested in was commenced about either January or February, 1945, very early in the year.

Q. And is that the time that you began also to investigate Rolly Goold's income tax liability for the year 1943?

A. That is right.

Q. And do you recall approximately when it was in the course of your investigation that you had a conference with, or a conversation with Mr. Rolly Goold?

A. I had various conversations with Mr. Goold from the first day I commenced the investigation until the investigation was finally completed.

Q. Did you have any conversation with him about the items on Exhibit 1, which is the Bill of Sale?

Mr. Smallpage. To which we object upon the ground that the question is leading.

The Court. Ask him whether he had any conversations.

Q. (By Mr. Marcussen). Did you?

The Court. Did you have any conversations?

A. I did.

Q. (By Mr. Marcussen). I hand you Exhibit 1-A, and ask you whether those are the items you had a conversation with him about.

Mr. Smallpage. To which we object upon the ground that is leading.

The Court. Sustained.

Mr. Smallpage. And I ask that the document be taken from the witness' inspection.

Mr. Marcussen. I don't see why he can't see an exhibit that has been offered in evidence. I am merely identifying the conversation, that is all.

The Court. Now, Mr. McCubbin, state whether or not you and Rolly Goold ever had a conversation with regard to the exhibit which is before you.

The Witness. We did.

Mr. Marcussen. Yes.

The Court. Now, what was that conversation?

Mr. Smallpage. To which we object upon the ground the proper foundation has not been laid, the time, place, the people present.

The Court. I will withdraw the question because it is improper for me to participate.

Mr. Marcussen. I will restate the question.

Q. (By Mr. Marcussen). Will you state what conversation you had with him about those items, please?

Mr. Smallpage. To which we object upon the ground the proper foundation has not been laid, two grounds, first, the people present, time and place, and for the further ground that this question is obviously for the purpose of discrediting Mr. Rolly Goold.

The Court. Objection overruled. You may answer, Mr. McCubbin.

A. As I remember, I asked Mr. Goold how these items were arrived at, and how their values were determined. To my best recollection, he

stated that at that time they were estimated, they were the closest figures obtainable at that time.

Does that answer the question?

Q. (By Mr. Marcussen). Did you have any conversation with Mr. Goold at all about the note that his son had given him to pay for those items?

A. I did.

Q. What conversation did you have with him about that?

Mr. Smallpage. May it be understood that my objection as to the time, place and people present is interposed to that question?

The Court. The same ruling. Go ahead.

A. I asked Mr. Goold if his son had ever made any payments on account of this note. He stated, "no," he had not, he didn't expect him to make any payments on the note.

Mr. Marcussen. Will you speak up a little bit?

The Witness. I asked Mr. Goold if his son had ever made any payments on this note, Mr. Goold stated, "no," he had not, that he didn't expect his son to make any direct payments because the note provided for payments of 25 per cent of the anticipated profits in these various joint ventures which would be applied against the note.

Mr. Smallpage. Would you give me your reporter's notation where that answer came, please?

The Reporter. Page 50.

Q. (By Mr. Marcussen). Did he say anything else?

A. I asked him—I don't remember exactly the questions that I asked him, but I do know that Mr. Goold——

Mr. Smallpage (interposing). Just a minute! To which we object upon the statement of the

witness that he doesn't remember the questions, that he——

The Court (interposing). Objection overruled. State what you know, Mr. McCubbin.

The Witness. I do know that——

Mr. Smallpage (interposing). May I take an exception to that, please?

The Court. Exception noted.

The Witness. I do know that Mr. Goold made the same statement to me that he has made here, that he couldn't rely on all the figures, and the records were there, he let the records speak for themselves, and he hesitated to answer a direct question in a definite manner for the reason that he was not familiar with income tax law and procedure, and he might get himself in a trap as far as his tax liability was concerned.

The Court. With regard to the last part of that answer, how is it material, Mr. Marcussen?

Mr. Marcussen. The materiality, if your Honor please, is that it shows that the petitioner is relying completely on counsel, it shows a knowledge on his part, that something is attempted to be done here, and he doesn't want to be led into any traps. Now, I think a statement of that kind is exceedingly material.

The Court. Go ahead. Any other questions?

Q. (By Mr. Marcussen). Now, did he say anything further about payments on the note, that you can recall?

A. I don't remember any further statements made by him, or any other questions asked by me in regard to this matter.

Mr. Smallpage. May I see the report, please?

Mr. Marcussen. No, I am not going to put it all in.

Mr. Smallpage. Well, you will put——

Mr. Marcussen. Well, let's not argue about it. Will you please read it?

Mr. Smallpage (examining document).

Mr. Marcussen. Excuse me, your Honor, for raising my voice.

Q. (By Mr. Marcussen). Now, I call your attention here to two paragraphs in this report, which is a report of a technical advisor, the paragraphs being on pages 6 and 7, and ask you just to read that over, this first paragraph.

The Court. Is this shown to the witness to refresh his memory?

Mr. Marcussen. Yes, your Honor.

Mr. Smallpage. And it is being shown to impeach his own witness.

The Court. Go ahead, Mr. McCubbin.

Mr. Marcussen. Just read it, don't read it out loud, just read it, this first part of the first paragraph on page 6.

Q. (By Mr. Marcussen). Now, does that refresh your recollection about anything that Mr. Goold told you about the prospects of payment on that note?

Mr. Smallpage. To which we except.

The Court. All right, state your objection.

Mr. Smallpage. To which we object upon the ground that the document shown to the witness is a typewritten document, it doesn't purport to be signed by the witness, is an obvious attempt to impeach the witness without the proper foundation being laid.

The Court. Objection overruled.

This document was given to you, Mr. McCubbin, for the purpose of refreshing your recollection. You are asked now to testify not to what this

document says, but upon the recollection that you have yourself independently of this document, which it refreshes in your mind, if it does.

Mr. Marcussen. That is correct.

The Court. Now, do you have such a recollection refreshed by this document?

Mr. Smallpage. May I examine the document, your Honor, to ascertain whether or not this witness signed that document, or prepared it, or was it prepared by somebody else?

Mr. Marcussen. I will identify the document further, if you wish.

The Court. Counsel can examine it, yes, I should think.

Mr. Smallpage. In other words, if I understand the law correctly—if not your Honor will correct me—I believe that a witness can only look at such document as he himself prepared for the purpose of refreshing his recollection, or one that was prepared under his direction. I asked counsel to let me look at the rest of the report——

Mr. Marcussen (interposing). I will withdraw the question at this time, if your Honor please.

The Court. The question is withdrawn.

Mr. Marcussen. And ask leave to terminate the examination of the witness at this time, and to put on another witness that will identify this document.

The Court. Well, do you want to continue with the direct examination of this witness on other matters?

Mr. Marcussen. No, your Honor.

The Court. Are you through with him?

Mr. Marcussen. I am through with him.

The Court. Cross-examine.

Mr. Smallpage. No questions.

Mr. Marcussen. All right. Step down.
The Court. That is all, Mr. McCubbin.
(Witness excused.)

And particularly we call this Court's attention to McCubbin's admission (Tr. p. 203):

"The Witness (McCubbin). I asked Mr. Goold if his son had ever made any payments on this note, Mr. Goold stated, "no", he had not, that he didn't expect his son to make any direct payments because the note provided for payments of 25 per cent of the anticipated profits in these various joint ventures which would be applied against the note."

(18) And at transcript pages 203 and 204:

"The Witness (McCubbin). I do know that Mr. Goold made the same statement to me that he has made here, that he couldn't rely on all the figures, and the records were there, he let the records speak for themselves, and he hesitated to answer a direct question in a definite manner for the reason that he was not familiar with income tax law and procedure, and he might get himself in a trap as far as his tax liability was concerned."

(19) Respondent's counsel, evidently disappointed in McCubbin's testimony, called Conferee Agent Mr. Wilker. We quote from the transcript, pages 207 to 223:

WILLIAM G. WILKER

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk. State your name and address.

The Witness. William G. Wilker.

Q. (by Mr. Marcussen). What is your occupation, Mr. Wilker?

A. Conferee of the Technical Staff.

Q. Of the Bureau of Internal Revenue?

A. Of the Bureau of Internal Revenue.

Q. And will you state briefly what are your duties as a Conferee on the Technical Staff?

A. We invite taxpayers to conferences for the purpose of discussing the matters in the case, and arranging a settlement, if possible.

Q. Do you also prepare reports in the course of your duties?

A. Yes, as a consequence we prepare a report of what we have done.

Q. Yes. Do you recall preparing a report in connection with the liability of the Petitioners in this case for the year 1943?

A. I do.

Q. I hand you this file in which is contained——

Mr. Smallpage (interposing). To which we object upon the grounds of immateriality. If counsel desires to introduce it through the witness, that is proper, but a report cannot be introduced in evidence as such.

Mr. Marcussen. I am not offering this in evidence, I don't propose to.

The Court. Well, I am at a loss to know what the question is leading to, then, Mr. Marcussen, the identification of a document which is not to be introduced in evidence.

Mr. Marcussen. If your Honor please, this is the same document which I handed to the preced-

ing witness, and the document is a document which was made by Mr. Wilker. This document contains a quotation from a document prepared by Mr. McCubbin, and I am simply going to identify it by this witness, that quotation, and then I am going to take it to Mr. McCubbin and ask him whether he recognizes it, have it further identified, and then present it to Mr. McCubbin and ask him whether it refreshes his recollection about a conversation he had, not with the taxpayer, but with the taxpayer's father, Mr. Rolly Goold.

The Court. Well, you are proving by this witness, then, that a quotation in the document is a quotation from some matter prepared by Mr. McCubbin himself?

Mr. Marcussen. Yes.

The Court. I see. All right, proceed.

Mr. Smallpage. To which we object upon the ground that that calls for a conclusion of the witness, and the original document is the document that should be produced. The petitioner here is placed in a most disadvantageous position when a government witness is permitted to say, who did not have the talk with the taxpayer, that a document which he holds in his hands is a copy of another document. Until they can show the loss of that other document they are not entitled to show a copy of it, that is fundamental law.

The Court. Objection overruled.

Mr. Marcussen. Very well.

The Court. You may answer, Mr. Wilker.

Mr. Smallpage. Exception, please.

The Court. Exception noted.

Mr. Smallpage. And in order that my objection might be made specific, it is because the proper foundation has not been laid in that it has

not been shown that the document from which the alleged quotation was taken is missing and cannot be produced for examination.

The Court. Go ahead.

Q. (by Mr. Marcussen). Now I call your attention to one of the documents contained in this file, and ask you whether the one referred to is a report prepared by you in connection with the liability of this taxpayer for the year 1943?

A. (examining document). It is.

Q. Is that your signature appearing on page 16 of the report?

A. Yes, sir.

Mr. Smallpage. To which we object upon the ground it is immaterial, what his report is concerning the liability of this taxpayer.

The Court. Overruled.

Mr. Smallpage. It is understood, I also assume, that in a conference held with the representative of the government, that the statements made there which involve compromises and cross questions are certainly not to be used against the witness, unless he himself had a transcription in shorthand, or it was by some other recognized means taken down.

The Court. Go ahead.

Mr. Marcussen. Now, if your Honor please——

The Court (interposing). Let's get the point of this.

Mr. Marcussen. I must make a statement to clarify the record at this point, if your Honor will indulge me.

The Court. I don't think the record needs clarification, because I think the record is clear. The purpose of this is merely to identify as a copy, from something that Mr. McCubbin wrote, two

paragraphs in this document which is before this witness.

Mr. Marcussen. Yes. I also wish the record to show, your Honor, that this is not a statement made by the taxpayer in any attempt to compromise his liability at all.

The Court. All right, go ahead. As I said before, the record doesn't need it because——

Mr. Smallpage (interposing). Well then, the objection is it is hearsay.

The Court. Go ahead.

Q. (by Mr. Marcussen). I call your attention to page 6 of this document, and I call your attention to the paragraph beginning slightly below the middle of the page, which reads——

Mr. Smallpage (interposing). Just a minute. Let him read it himself.

Q. (by Mr. Marcussen). I will ask you to read it.

A. "The above mentioned——"

Q. (interposing). No.

The Court. No.

A. "——Revenue Agent's report——"

Q. (by Mr. Marcussen) (interposing). Just read it silently, Mr. Wilker.

A. Oh, excuse me. I am sorry, I am sorry.

Q. Have you read it?

A. Yes.

Mr. Marcussen. Do you want to see it, counsel?

Mr. Smallpage. Yes, certainly, I want to see the whole document.

Q. (by Mr. Marcussen). I ask you to state——

Mr. Smallpage (interposing). Just a minute! Let me read the whole document.

Mr. Marcussen. No, the document is not in evidence. The document consists of sixteen pages. It is a confidential document. I am merely establishing a quotation from a particular page, your Honor.

Mr. Smallpage. It would seem to me, your Honor, that if any portion of this document can be shown to the witness it should be shown to the counsel for the Petitioner.

The Court. Go ahead. The only purpose of this, as I see it, is to get two paragraphs identified as from a letter, or a statement, or a document prepared by Mr. McCubbin. That is the only relevancy of this at all.

Mr. Smallpage. Alleged to have been prepared.

The Court. Well, that is all right, alleged to have been. I don't know. Let the witness testify. The rest of the document is irrelevant and immaterial, we are not interested in it.

I don't take it that counsel for the government is interested in it.

Mr. Marcussen. That is right.

The Court. The rest of the document would be totally irrelevant and immaterial, because, as you pointed out, the proceedings before the Conferee, before any settlement proceedings, are as though they were nothing in the proceeding here. We are not interested in any statements made or in any action taken by way of settlement.

Mr. Smallpage. All right. Then is this not fair, your Honor, that before they produce a copy made by a third person, why don't they produce the report itself? It must be in the files of the government. I don't think that is an unfair request. Why don't they produce Mr. McCubbin's own report? I have no objection to that.

The Court. Let's go ahead. The point of argument here is with regard to this witness' examination as to those paragraphs.

Now proceed, Mr. Marcussen.

Q. (by Mr. Marcussen). Now I would like to ask you, Mr. Wilker, about these two paragraphs which are in quotation marks, and ask you where you got those two paragraphs that are quoted on pages 6 and 7 of this report.

A. From a report by the Revenue Agent.

Q. And who was the Revenue Agent?

A. Mr. McCubbin.

Q. Yes. And at the time that you inserted these two paragraphs from that Revenue Agent's report in this report, did you have the Revenue Agent's report before you?

A. I did.

Q. And it was taken from that?

A. Yes.

Q. Do you know where that report is now?

A. No.

Mr. Marcussen. That is all that I have to ask of this witness.

The Court. That is all, unless there is cross examination.

Mr. Smallpage. Yes, I would like to know what became——

The Court (interposing). All right.

Cross-Examination

by Mr. Smallpage.

Q. Mr. Witness, how voluminous was that report of Mr. McCubbin's from which he took this extract?

A. Oh, I don't recall.

Q. Well, was it four pages or ten pages?

A. Oh, more likely ten, but I am not certain.

Q. It was a bound volume, or a bound report, was it not?

A. Well, no, not bound, that is, it was a sheaf of papers fastened together, I presume, with a staple or fastener.

Q. It is a part of the government records, in so far as this transaction is concerned?

A. It was when I had it.

Q. And you treated it as such, did you not?

A. Oh, yes.

Q. Now, what did you do with it?

A. I associated it with the file when I transmitted the file to my superiors.

Q. That is to say, it was filed with this document of which this is alleged to be a copy, is that right?

A. Pardon me?

Q. It was filed with, or associated with you—by the way, what do you mean by the word "associated" by you?

A. Put into the files, placed with the docket, or with the folder that I had for the case.

Q. And was it stapled at the time?

A. No.

Q. But it was at least put in there in the same way your report was?

A. Well, it was kept separate, my report was, upon the petitioner, the partnership report was a separate document, kept separate from that file, that is, it was not bound in a jacket like this.

Q. All right, but you put it in the jacket when you returned it?

A. Oh, yes; oh yes.

Q. To whom did you return it?

A. It went to my superior.

Q. Who is that?

A. Mr. Lowder and Mr. Harlacher, from there it would go to the file clerks.

Q. Have you made any search to ascertain whether or not that document is not in the files at the present time?

A. No.

Q. Has anyone ever requested of you that you make a search to ascertain?

A. No.

Q. Now, in the preparation of your report, did you dictate that particular paragraph, or did you give Mr. McCubbin's alleged report to a stenographer and tell her to make a transcription?

A. I told her to make a transcription and checked it.

Q. And is that the only portion of his report that is included?

Mr. Marcussen. Object to that, it has no materiality, if your Honor please.

Q. (by Mr. Smallpage). That is included in this document?

A. As a quotation?

Mr. Marcussen. Objection on the ground it is immaterial, your Honor, and going to take time.

The Witness. It is the only part I see quoted.

The Court. All right, any other questions.

Mr. Smallpage. That is all.

The Court. That is all.

Mr. Marcussen. Now, just a moment, Mr. Wilker.

Redirect Examination
by Mr. Marcussen.

Q. You testified that the Revenue Agent's report was returned to the file. Is that the same as this file that is involved in this proceeding?

A. When I said to the files, I meant to our file room in our office room. From there I can imagine that it was returned to the Revenue Agent's office.

Q. I see.

And I think you testified that that was a report of the partnership, the analysis of the partnership income?

A. Yes, yes, this was on the partnership.

Q. Well, in the ordinary course of Bureau procedure, would that document be placed in this file, or would it be returned to the partnership file?

A. It was returned to the partnership file.

Q. Yes. And do you recall whether I asked you to look for that in this file? Have you made a search?

A. Yes, I have looked in this file.

Q. And did you find it?

A. No.

Mr. Marcussen. That is all.

The Court. That is all, sir.

Mr. Smallpage. Just one minute.

Recross Examination
by Mr. Smallpage.

Q. Mr. Witness, at the time that Mr. Scott and Mr. Goold and his son and myself were in your office, did you at that time have Mr. McCubbin's report before you?

Mr. Marcussen. Object to it on the grounds it is immaterial. We are not concerned about any conferences that took place.

The Court. I don't think it is material.

Mr. Marcussen. In the Technical Staff, that is the whole point.

The Court. I will sustain the objection.

Q. (by Mr. Smallpage). Did you at the time that we had that conference make any statement to us individually or collectively that Mr. Goold had made any statement to Mr. McCubbin with respect to the terms under which he had sold this property to his son?

Mr. Marcussen. Objection on the grounds that it is not proper cross-examination, not within the scope of the direct.

The Court. I will sustain the objection.

Mr. Smallpage. That is all.

The Court. That is all, sir.

(Witness excused.)

Mr. Marcussen. Recall Mr. McCubbin, please.

Whereupon,

BRUCE McCUBBIN,

recalled as a witness for and on behalf of the Respondent, having been previously sworn, was examined and testified further as follows:

Direct Examination
by Mr. Marcussen.

Q. Now, Mr. McCubbin, I want to call your attention to page 6 of this report which has been identified by the preceding witness, and I call your attention to the second last paragraph on the page which appears in quotation marks, and

is the first of the two paragraphs which the preceding witness identified, and I ask you——

The Court (interposing). You might just ask him whether that refreshes his recollection or not.

Q. (by Mr. Marcussen). Yes, whether that refreshes your recollection as to any conversation that you had with Rolly Goold as to the subject of making payments on the note?

Mr. Smallpage. Just a minute, if your Honor please.

The Court. All right.

Mr. Smallpage. That document should never have been shown to this witness until I have had an opportunity to object to it. It is an attempt to impeach his own witness without the proper foundation being laid. The phraseology contained in these two paragraphs is at distinct variance with what the witness testified to on direct examination. Now, it is most assuredly unfair to this witness to be presented with a document which he himself does not know is a quotation from a report which was made by him, and in view of the fact that the government has shown no attempt, no effort whatsoever to go over to their file room and get the other document which certainly must be in existence, the original report from which that document that extract was taken is in existence, it is right here. We have produced for the government some, I think, 50 exhibits. We only had three or four. They required and asked us repeatedly up to Saturday to produce different exhibits. Now, certainly they have had the opportunity to go over there and bring that partnership report here, and if they wanted to refresh

Mr. McCubbin's mind, they could have had it here to do so, and to rely upon an alleged copy made by a stenographer who was told to copy a paragraph is most unfair to the witness, and does not constitute the proper foundation for an impeachment of their own witness. That is exactly what this is.

The Court. Objection overruled.

Does this refresh your recollection?

The Witness. It does.

Q. (by Mr. Marcussen). Now, can you testify after your recollection is refreshed as to what Mr. Rolly Goold did tell you about payments on the note?

Mr. Smallpage. Just a minute! To which we object upon the ground that the question has been asked and answered in direct conversation.

The Court. Overruled.

A. Well, he stated he had received——

The Court (interposing). Now you are testifying from your own recollection?

Mr. Smallpage. Listen, let's remove the document from the witness'——

The Court (interposing). You are not testifying from any document, it is just what you remember now from your own recollection of it.

Mr. Smallpage. Let's put it up here.

Mr. Marcussen. Let's leave it here. I have covered the page.

The Witness. As I remember, Mr. Goold stated that he had received no payments on the note, and he didn't expect to receive any direct payments on the note. As I recollect, Mr. Goold stated that he at that time had received no payments on the note, and did not expect to receive any payments on the note.

Q. (by Mr. Marcussen). Now, is there any doubt about it in your mind at all, as to whether he made that statement to you?

A. No, there never was.

Mr. Marcussen. That is all.

Mr. Smallpage. Will you please refer back to the witness' testimony that he gave on direct ex-examination, wherein he stated that Mr. Goold did not expect his son to make payments on the note, but his money on the note was to come out of his son's share of the profits of the business? Please refer to that testimony that the witness gave.

The Court. Was that the part that you asked the reporter to make a notation on?

Mr. Smallpage. It is right about in there, if your Honor recalls that testimony.

The Court. Well, the testimony will appear when the transcript is made up. You may cross-examine the witness on the assumption that he did make the statement.

Mr. Smallpage. Thank you. I did not want to make cross-examination on an erroneous assumption of fact.

The Court. All right.

Mr. Marcussen. Now, will it be understood that you will state to the witness what you understood his statement was?

Mr. Smallpage. Please refer back to your notes, page 50.

The Court. I don't know if the reporter can find it. Do you think you can?

(The testimony referred to was read by the reporter, as follows:)

"Answer. I asked Mr. Goold if his son had ever made any payments on account of this

note. He stated, 'no,' he had not, he did not expect him to make any payments on the note."

The Court. All right, that is enough. Your assumption is correct.

Mr. Smallpage. I thought it was.

Cross-Examination

Q. (by Mr. Smallpage). Now, that is a fact what he said, isn't it, Mr. McCubbin, your testimony is true and correct as given in your direct examination and as reported by this young lady?

A. That is correct, but I still believe that both of my statements——

Q. (interposing). Just a minute!

The Court. Not what you believe, what he said. Now, you said once that he said he didn't expect any direct payments because he was going to get payment out of the profits.

The Witness. That is right.

The Court. All right, it is not what you believe, it is what he said.

The Witness. All right.

Q. (by Mr. Smallpage). Now, Mr. McCubbin, in your report you never made any contention that this transaction between Goold and his son was a gift and not a purchase, did you?

Mr. Marcussen. Object to that on the grounds it is improper cross-examination.

The Court. Sustained.

Mr. Smallpage. All right, I call for the report.

The Court. All right, it does not make any difference what Mr. McCubbin contended with regard to it, we are interested in what the facts are.

Mr. Smallpage. That is right. All right.

> The Court. Yes, it is irrelevant.
>
> Mr. Smallpage. The point I want to make is this: That is if he had received any evidence to the effect that this was a gift and not a purchase transaction, he should have so reported it in his return, which he did not, and I submit it is a matter of fact that he made no such return. I am not privileged, as I understand the law, to examine these Internal Revenue Agents' reports. That is correct, is it not, your Honor?

Boiled down, respondent's counsel had Conferee Wilker identify a report made by the latter in this matter, presumably as a result of a conference between Son and himself, in which he included an alleged two paragraphs of a different report claimed to have been made by McCubbin in this matter. Wilker admitted, upon cross-examination, that he gave the McCubbin report to a stenographer to copy the two paragraphs in question, into his report, which was then before the Court. Now, we respectfully call the attention of this Court to this extraordinary procedure which took place in a United States Court: The Wilker report was shown to him (Wilker). Counsel for Son asked permission to look at the report. This permission was denied by the Tax Court upon the objection of respondent's counsel that it was privileged. Counsel for Son was not allowed even to examine these so-called two paragraphs which Wilker identified. Thereafter, McCubbin was put on the stand and asked to look at these same two paragraphs, and from reading them, to refresh his recollection of what Father Goold had stated. McCubbin still, how-

ever, testified in accordance with his previous statement. Counsel for Goold demanded the production of the McCubbin report, of which these two paragraphs had been presented to the witness. We were denied this right, even though it is obvious, from the aforesaid testimony, that the McCubbin report was in the files of either respondent's counsel or in the government itself. Since respondent's counsel arbitrarily refused to produce this report, it is a reasonable deduction, and it is the rule of evidence that we must assume that the report contained matters favorable to the contention of Son.

(20) It is the duty of the Courts to protect the government against the illegal claims of its citizens, but it is equally an important function of this Court to protect its citizens against the unreasonable, unlawful usurpation of power by those entrusted therewith.

(21) Again we call the attention of the Court to the questionable tactics used in this case. We quote from Transcript, pages 177 to 187:

> Q. Now, I think the evidence that has been introduced here will show that your son even for the year 1943 had a share in the profits of $60,000, and the evidence will also show substantial earnings for the succeeding years, '44, '45, '46 and '47, and I ask you whether you have any explanation as to why, since the conclusion now of all these income tax matters relative to the recognition of the partnership, why wasn't his share of the earnings endorsed on that, and why wasn't

his share devoted to paying his obligation on this note?

A. Frankly, I didn't think there was a conclusion of the Internal Revenue matter. I thought that is what brought us here at the present time.

Q. The partnership is recognized, you understand that, don't you?

A. No, I have no assurance that the partnership is recognized. I understood that the partnership was being attacked in this proceedings.

Q. Well, if you were told that the partnership is not being attacked in these proceedings, and that your attorney knows that, and that he knew it was not being attacked from the beginning, way back in 1945, now, do you have any other explanation that you want to make as to why your son's share of the earnings were not applied in the payment of this note in accordance with the terms of the note?

A. Just a matter of confusion.

Mr. Smallpage. To which we object upon the ground that counsel has made a misstatement of fact, your Honor.

The Court. Objection overruled.

Mr. Smallpage. Well, may we——

The Court (interposing). The objection is overruled. The witness may answer.

Mr. Marcussen. Can you answer?

The Witness. Will you repeat the question, please?

(The pending question was read by the reporter, as follows:

"Question. Well, if you were told that the partnership is not being attacked in these proceedings, and that your attorney knows that, and that he knew it was not being attacked

from the beginning, way back in 1945, now, do you have any other explanation that you want to make as to why your son's share of the earnings were not applied in the payment of this note in accordance with the terms of the note?")

Mr. Smallpage. I respectfully suggest, your Honor, that that is assuming a fact not in evidence. The partnership was continuously under attack until August the 8th, 1946, when it was recognized.

The Court. Objection overruled. He is asked to assume certain facts.

If you assume the facts stated by counsel for the respondent, what is your answer? Have you got any other reason why your son didn't make any payments on these notes?

The Witness. No.

The Court. This note? That is the only reason you have, that there was trouble with the Bureau of Internal Revenue, is that right?

The Witness. That is correct, yes, sir.

Q. (by Mr. Marcussen). Now, was it your purpose in making this purported sale to your son to have him pay merely for one-half the value of these assets transferred?

A. That is the terms of the note, I believe, sir, yes.

Q. Well, I call your attention to the fact that in the Bill of Sale——

A. (interposing). The terms are in the Bill of Sale.

Q. —the total of the assets transferred is $161,000 some odd, and that he signs a note for $100,000.

A. Well, I have no explanation on that as to why that amount was set up at $100,000, except for the fact these items down here were unknown at that particular time.

Q. They turned out actually to be less, but even on the figures that you have got on the Exhibit 1, the total of the assets in which you are conveying to him one-half interest totaled $161,000, and you have him sign a note for $100,000. Do you have any explanation to offer for that?

A. The note was prepared by counsel. Just what the particular reasons for it were I couldn't tell you.

Q. Did counsel determine the amount of the note?

A. No, counsel determined the amount of the note, the amount of the note——

Q. (interposing). Was $100,000. Now, who decided upon that $100,000?

A. I believe that it was counsel who decided to set the note up at $100,000, and make subsequent adjustments if it became necessary as to what the figures should be.

Q. And now, at the time that you received this note and had your son sign it, did you ever expect to receive any payments from him on it?

A. I certainly did.

Q. Full payment?

A. Yes, sir.

Q. After adjustments were made for any errors?

A. That is right.

Q. And valuation of certain items included on the Bill of Sale?

A. At the time this note was prepared it was my expectation that he would pay the note in accordance with the terms of the note.

Q. Yet you never insisted that any of the profits be devoted to it, even after the income matter was cleared up?

Mr. Smallpage. Objected to, stating a fact not in evidence. The income tax matter was not straightened up.

The Court. That part of the question will go out. The answer is that he never insisted on his son paying any part of the note.

Q. (by Mr. Marcussen). Now, do you ever recall talking to Mr. McCubbin about this case, who was an Internal Revenue Agent who came out to see you?

A. Some slight conversation. Mr. McCubbin spent considerable time in our office.

Q. Do you ever recall that he questioned you about the amount of the costs of the interest included on the Bill of Sale, and their fair market value, and do you ever recall telling him that you never expected to be paid anything on that note?

Mr. Smallpage. One minute. To which we object on the ground the proper foundation has not been laid, the time, place and people present, and the conversation at least substantially given.

The Court. Objection overruled.

Do you recall that?

Q. (by Mr. Marcussen). On your oath?

The Court. Do you recall saying that?

A. The answer is "no," I don't recall.

The Court. The answer is "no."

Q. (by Mr. Marcussen). Do you recall stating to Mr. McCubbin that this matter had been in the

hands of your attorney, and that he had prepared the matter, and that you knew nothing about income taxes, and that, in answer to his questions, you didn't want to fall into any trap?

A. I don't recall any such conversation about falling into any trap, no, sir.

Q. You don't recall?

A. No, sir.

Mr. Marcussen. That is all, your Honor.

Mr. Smallpage. Will you stipulate that that is a true and correct copy of the original letter from the Conferee's office respecting this matter, from the Internal Revenue Department?

What time does your train leave, your Honor?

The Court. That is all right, we will go right ahead.

Mr. Smallpage. I have only taken 25 minutes.

The Court. That is all right, don't be alarmed.

Mr. Marcussen (examining document). No objection.

Mr. Smallpage. We offer this in evidence.

The Court. It will be admitted in evidence.

Mr. Smallpage. And ask it be marked next in order. For continuity, I want to say, your Honor, it is a letter of compromise from the Department with respect to recognizing the partnership, providing that we do certain things, and the date of it is August, 1946.

The Clerk. Exhibit 28.

(The letter referred to was marked and received in evidence as Petitioner's Exhibit No. 28.)

Petitioner's Exhibit No. 28

Treasury Department
Internal Revenue Service
San Francisco 5, Calif.
August 20, 1946

Office of
Internal Revenue Agent in Charge
San Francisco Division
74 New Montgomery Street

In Replying Refer to IRA:Conf-ALW

Mr. LaFayette J. Smallpage
Room 511, Savings and Loan Bank Building
Stockton, California

In re: R. Goold and Son
R. Goold
E. R. Goold
Stockton, California

Year: 1943

Dear Mr. Smallpage:

In further reference to the protests filed by you with respect to the above-named taxpayers for the year 1943, the following adjustments are suggested as a basis for settlement. In case you are willing to close the cases on this basis, the result will be subject to approval by the reviewing authorities in this office and in the Bureau.

(a) To recognize the partnership between R. Goold and E. R. Goold.

(b) To consider the transfer of an undivided one-half interest in the partnership assets as a gift to the son instead of a sale as claimed; gift tax to be adjusted and determined later.

(c) To consider that the son's interest in the partnership is his separate property, and that his

distributive share of the partnership profits is taxable in full to him except one-half of a reasonable salary for his services of $5,000.00, or $2,500.00, which amount will be taxed to his wife, as her one-half share of the community income.

(d) Since the deduction of $2,211.00 claimed for Mr. R. Goold's expenses in connection with the Marysville job was incurred over a period of 67 weeks running from March 23, 1942 to September 1943, and since there are no records to verify such expenditures, a deduction will be allowed of $500.00 to cover cost of meals and lodging at Marysville for estimated 35 trips made in 1943 and for automobile expense. Mr. Goold used an automobile which belonged to the electrical appliance business and it is assumed that most of the expenses of this car were included in automobile expenses claimed and allowed to that business.

(e) If the above-stated adjustments are acceptable to the taxpayers, the personal exemption and credit for dependents will be allowed in full to E. R. Goold since this adjustment will be to the mutual tax advantage of E. R. Goold and his wife.

Please advise this office at the earliest available time as to whether the settlement as set forth above is acceptable to the taxpayers in question. Another hearing in this office for further discussion of the issues and the basis of settlement will be granted upon written request.

Very truly yours,
/s/A. L. Wilkinson,
Conferee Revenue Agent.

ALW:eh
cc to Mr. R. Goold and
Mr. E. R. Goold

Mr. Smallpage. It will be considered as read in evidence?

The Court. That is right.

Mr. Smallpage. That is, the significant portion.

The Court. I don't have to get away from here until three o'clock, I just want counsel to know.

Mr. Smallpage. I am hurrying my examination along a little, but I took account of my time. I have exactly 25 minutes.

I ask that this document be marked Petitioner's Exhibit for identification next in number.

The Clerk. Marked for identification only Exhibit 29.

(The document referred to was marked as Petitioner's Exhibit No. 29, for identification.)

Redirect Examination
by Mr. Smallpage.

Q. I present this document to you, which has been taken out of my file, respecting this matter, which is entitled, "Assets conveyed to Everett R. Goold, January 1, 1943, which becomes the assets of partnership R. Goold and Son."

I ask you if that document was given——

Mr. Marcussen (interposing). Object to the question on the grounds it is leading, and ask counsel, if your Honor please, to ask the witness what that document is.

The Court. All right, what is it, Mr. Witness?

Mr. Smallpage. Wait a minute, may I——

The Court. All right, reform you question.

Mr. Smallpage. I just gave the title.

Q. (by Mr. Smallpage). Was that document delivered by you to me?

Mr. Marcussen. Object to that on the ground it is a leading question.

The Court. Objection sustained.

Mr. Smallpage. A leading question to ask him if he gave it to me?

The Court. That is right.

Mr. Smallpage. Do we take exceptions?

The Court. Exception noted. The witness can be asked to describe that letter, or that document, what it is, and what he did with it, if he knows. This is direct examination, redirect examination.

Q. (by Mr. Smallpage). Well, is that document in your handwriting?

A. The document is in my handwriting, yes, sir.

Q. All right. What did you do with it?

A. This was a document that was turned over to you at the time that we were preparing to sell this partnership interest, half of it, to sell this partnership interest on January the 1st, 1943, and in my writing down here I have subscribed "the above is the interest of R. Goold on the above day, and are the assets of the partnership. All of the above is community property of R. Goold and Katharine Goold, his wife."

Q. I call your particular attention to the words, "estimated."

A. Opposite two of the accounts here I have written the words "estimated" because of the fact we weren't able to determine the value at that time.

Mr. Smallpage. We ask that this be admitted in evidence.

The Witness. The books didn't disclose that.

The Court. Admitted.

The Clerk. Exhibit 29.

The assumption adopted by respondent's counsel that the partnership between Father and Son had been recognized by respondent in the year 1945 is a positive misstatement of fact, and we charge now that respondent's counsel personally well knew that it was not until August 5, 1947, that there had been an admission by the Government of the validity of this partnership. Even in his brief, respondent's counsel utilized many pages in attacking this partnership, as though there were something viciously wrong in a Father making his son a partner; a Son who was actively engaged in the operation of the business.

SECOND QUESTION.

Facts.

(A) This Second Question has been raised by the petitioner's fourth assignment of error. It involves solely a narrow question of the interpretation of the provisions of section 451(a)(3), Internal Revenue Code. The statutory provisions in question, which were added to the Internal Revenue Code by section 172(a), Revenue Act of 1942, and repealed by section 6(a), Individual Income Tax Act of 1944, read as follows:

> "Sec. 451(a) Definition.—The term 'Victory tax net income' in the case of any taxable year means * * * the gross income for such year * * * minus the sum of the following deductions:
> * * * * * * *
> "(3) Taxes.—Amounts allowable as a deduction by Section 23(c) to the extent such amounts are

paid or incurred in connection with the carrying on of a trade or business, or in connection with property used in the trade or business, or in connection with property held for the production of income."

(B) In the proceeding below the petitioner argued substantially as he does hereunder for a construction of the said section 451(a)(3) which would include in the deductions to be made in computing "victory tax net income" income taxes on business income levied by the State of California which had been paid or accrued in the period (in this case the calendar year 1943) for which the victory tax was levied. The Tax Court thought that such California income taxes on business income were not included in the terms of the said section 451(a)(3) and upheld the respondent's disallowance of such income taxes as a deduction in computing victory tax net income adhering to its opinion in the earlier case of *Anna Harris et al.*, 8 T. C. 818, a petition to this Court of Appeals for review of which was filed on another issue.

ARGUMENT.

(1) THE CONSTRUCTION OF SECTION 451(a)(3), I. R. C., REQUIRES NO EXTRANEOUS AIDS.

The statutory provisions in question are unambiguous. In such a case the Tax Courts should not have looked beyond the language of the statute itself. As stated in 25 Ruling Case Law 962—

"* * * When the language of the statute is plain and unambiguous and conveys a clear and definite meaning, there is no occasion for resorting to the rules of statutory interpretation and construction; the statute must be given its plain and obvious meaning. This principle is to be adhered to notwithstanding the fact that the court may be convinced by extraneous circumstances that the legislature intended to enact something very different from that which it did enact."

To the same effect, see also *Lake County v. Rollins,* 130 U.S. 662; *United States v. Merriam,* 263 U.S. 179 (T.D. 3535, C. B. II-2, 87); *Penn Mutual Life Insurance Co. v. Lederer,* 252 U.S. 523 (T.D. 3046, C. B. 3, 249); *New York Telephone Co. v. Treat,* 130 Fed. 340, certiorari denied 198 U.S. 584; *Isslin v. United States,* 270 U.S. 245, 70 L. Ed. 566, 46 S. Ct. 248 (1926); *Caminetti v. United States,* 242 U.S. 470, 61 L. Ed. 442, 37 S. Ct. 192 (1917); and *Lewis' Sutherland Statutory Construction,* section 363. Cf. G.C.M. 7285, C. B. IX-1, p. 181, a ruling on behalf of the respondent's predecessor in office, at page 184.

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(2) THE TERMS OF SECTION 451(a)(3) PLAINLY INCLUDE CALIFORNIA INCOME TAXES ON BUSINESS INCOME.

Section 451(a)(3) as copied above makes dual requirements for deductions of taxes (1) that they be allowable under the provisions of section 23(c) and (2) that they be "paid or incurred (a) in connection with the carrying on of a trade or business, or (b) in

connection with property used in a trade or business, or (c) in connection with property held for the production of income".

As to the first requirement, the Tax Court has held in *Mary E. Evans, et al.,* 42 B.T.A. 246 (1940), that California income taxes are deductible under section 23(c).

As to the second requirement, attention is directed first to the broad statement of the requirements which adds to the general statement in Clause (a) "in connection with the carrying on of a trade or business", two alternative clauses (b) "in connection with property used in a trade or business" (apparently to obviate any question of the inclusion of ad valorem, use or similar taxes on property), and (c) "in connection with property held for the production of income" (apparently to permit deductions of taxes levied on property held for rents, dividends or interest whether or not such income is actually received in any particular taxable year). Just as in the case of the other deductions from gross income described in subsection 451(a)(1) to (7), inclusive, the obvious intent of this designedly expansive description of deductible taxes is to bring the allowance within the class of "expenses or other allowable deductions connected with a trade or business, or incurred in connection with the management, conservation or maintenance of property held for the production of income". Compare explanation in Senate Report No. 1631, Seventy-seventh Congress, Second Session, by the Committee on Finance, C. B. 1942-2, pp. 508 and 624.

In the case of this or any other taxpayer residing in California, income from business is subject to a graduated income tax on a basis of constitutional authority and definitions quite similar to the Federal income tax. For text see Chap. 329, California Statutes 1935, as amended. Such a tax is under the rule of *Pollock v. Farmers Loan & Trust Co.,* 157 U.S. 429, 29 L. Ed. 759 (1895) a direct tax. See also *Mertens, Law of Federal Income Taxation,* Sec. 4.07 and 4.08 (V. 1) pages 131-135, and numerous citations in notes. This income from the business of this petitioner was a measure of a definite part of his California income taxes incurred or paid. If a tax so based, caused and measured with reference to business income is not, in the terms of the statute, "incurred in connection with the carrying on of a trade or business", no other tax could possibly be so incurred. Without the business there would be no income from it and no state income tax. The relation of the business to the tax is one of cause and effect. The term "in connection with" used abstractly as in this statute can have no other applicable meaning than "having a causal or ~~lorical~~ logical relationship with". (Cf. Webster's New International Dictionary, Second Edition.)

(3) THE RESPONDENT'S CONSTRUCTION OF SECTION 451(a)(3), I. R. C., TO EXCLUDE DEDUCTIONS OF STATE INCOME TAXES ON BUSINESS INCOME IS FALLACIOUS AND ERRONEOUS.

The respondent has attempted in I. T. 3644, C. B. 1944, p. 372, to construe Sec. 451(a)(3), I. R. C. to exclude state income taxes on individuals from the deductions allowable for the victory tax even to the extent that these taxes may have been levied on business income, rents, dividends, and other income from property. As we have shown above the language of the statute clearly and unequivocally allows the deduction of state income taxes on, or measured by, income from business. In ruling to the contrary, the Commissioner has assumed and appropriated an authority of construction and interpretation contrary to the fundamental rule of statutory construction discussed under proposition (1) above.

The ruling in question is based on an argument (1) that the Congress intended to restrict, for victory tax purposes, the deductions ordinarily allowed by section 23(c) of the Code because (a) the language of section 451(a)(3) expressed a restriction, and (b) because the Committee on Finance of the Senate stated in explanation of the limitation of the tax in section 456 (Senate Report No. 1631, Seventy-seventh Congress, Second Session, C. B. 1942-2, 509), that:

> "*Since the victory tax does not allow any deduction for State income taxes,* your committee deemed it advisable to provide that the total income tax and victory tax should not exceed 90 per cent of the taxpayer's net income * * *." (Italics in I. T. 3644.)

and concluded (2), without further explanation or elucidation, that the intended restriction excluded income taxes on business income, rents, dividends and similar income from property. The *non sequitur* of the conclusion is apparent from this analytical statement of the argument.

The Congress did intend to restrict, for victory tax purposes, the deductions ordinarily allowed by section 23(c) and, as shown in our exegesis in proposition (1) of this argument, stated that restriction in section 451(a)(3) clearly, succinctly and beyond the need of any interpretation based on the congressional report, in terms which clearly allow the deduction of state income taxes on business income. But if aid from the report were needed, the explanation of the deduction provisions in the Senate Report cited at pp. 508 and 624, C. B. 1942-2, is not indicative of any intention whatever to exclude state income taxes.

The statement of the Committee on Finance in explanation of the limitation feature of the victory tax law (Subchapter D of Chapter 1 of the Internal Revenue Code) in section 456 that the limitation was provided because "the victory tax does not allow any deduction for State income taxes" was directed to and explained only the provisions of section 456; it was not even intended to explain the provisions of section 451(a), let alone modify the plainly stated terms of subdivision (3) thereof. It should be compared, too, to the Committee's detailed discussion of section 456 (C. B. 1942-2, p. 626) which makes no reference to state income taxes. The Committee no

doubt had in mind, in considering the limitation provision, that the handful of individuals to which its terms would apply would normally have considerable income from salaries, commissions, annuities, etc. on which the income taxes levied by the States would not be deductible under the provisions of section 451(a)(3), thereby creating a situation in which the combined levies for the Federal income and victory taxes and the personal income taxes of the states at the rates prevailing in some of them (notably New York and California) in 1942 would exceed 100 per cent of the taxable income; hence the limitation of the combined Federal income and victory taxes to 90 per cent to halt the confiscatory effect of the combined Federal and State income taxes. Any such considerations, whatever they may have been in detail, had no bearing on the provisions of section 451(a)(3) even if the general statement italicized in the quotation in I. T. 3644 had been literally in harmony with those provisions, instead of only partly so, i.e., only with respect to income taxes on compensation for services, annuities, etc. As we have noted above, it does not at all follow by any rule or logic or of statutory construction from the Committee's statement with regard to the limitation in section 456 that state income taxes on business income were excluded from the deductions allowed by section 451(a)(3). When the draftsman of I. T. 3644 read into the phrase of the Committee's explanation of section 456 an explanation of, or a narrowing of, the allowances of taxes by section 451(a)(3), he was simply reading something that is not there. The process by which he so read it, whether

by preconception of the meaning of the subparagraph (3) in question, or by some erroneous notion as to the rules of statutory construction, as to which the hiatus between the premises and the conclusion in that ruling leaves us completely uninformed, is of no importance; what is important is that the phrase in question has no relation to the meaning of section 451(a)(3).

The Court below has upheld the respondent's disallowance of the accrued California income tax on business income on the authority of its holding in an earlier case, *Anna Harris, et al.,* 10 T. C. 818 (now pending on a petition for review before this Court of Appeals), involving in part the same issue. It is suggested that in her opinion in the *Harris* case Judge Harron of the Tax Court has fallen into the same fallacies of statutory construction and of interpreting the congressional committee reports as did the draftsman of I. T. 3644, and that her opinion should therefore be overruled.

CONCLUSION.

As to the First Question, we believe that a fair consideration of the evidence in this case will lead this Court to rule that this transaction was not one of gift, but one of sale, and that the petitioner should have judgment.

As to the Second Question, since we have shown that according to the correct rule of statutory construction, proposition (1), section 451(a)(3) of the

Internal Revenue Code includes and permits the deduction of California income tax on business income in computing victory tax net income (proposition (2)), and that the respondent's ruling to the contrary in I. T. 3644 and the opinion of the Court are fallacious and erroneous interpretations of the statute (proposition (3)), it follows that the disallowance of the deduction in question by the respondent and the Tax Court should be disapproved and overruled.

Dated, Stockton, California,
December 28, 1949.

Respectfully submitted,

LAFAYETTE J. SMALLPAGE,
Attorney for Petitioner.